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No. 616

In the Supreme Court of the United States

OCTOBER TERM, 1960

RADOM & NEIDORFF, INC., PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

BRIEF FOR THE UNITED STATES IN OPPOSITION

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OPINION BELOW

The opinion of the Court of Claims (Pet. 21-32) is reported at 281 F. 2d 461.

JURISDICTION

The judgment of the Court of Claims was entered on July 15, 1960, and a timely petition for reconsideration was denied on October 5, 1960. The petition for certiorari was filed on December 30, 1960. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1255(1).

QUESTION PRESENTED

Whether Section 24(c) of the Internal Revenue Code of 1939, prohibiting deductions for unpaid business expenses in certain particularized circumstances, is to be applied only when taxpayer has a tax avoidance motive.

STATUTE INVOLVED

Internal Revenue Code of 1939:

SEC. 24. ITEMS NOT DEDUCTIBLE.

* * * * *

(c) [As amended by Sec. 202(a), Technical Changes Act of 1953, c. 512, 67 Stat. 615] *Unpaid Expen. and Interest.*—

In computing net income no deduction shall be allowed under section 23(a), relating to expenses incurred, or under section 23(b), relating to interest accrued—

(1) If within the period consisting of the taxable year of the taxpayer and two and one-half months after the close thereof (A) such expenses or interest are not paid, and (B) the amount thereof is not includible in the gross income of the person to whom the payment is to be made; and

(2) If, by reason of the method of accounting of the person to whom the payment is to be made, the amount thereof is not, unless paid, includible in the gross income of such person for the taxable year in which or with which the taxable year of the taxpayer ends; and

(3) If, at the close of the taxable year of the taxpayer or at any time within two and

one-half months thereafter, both the taxpayer and the person to whom the payment is to be made are persons between whom losses would be disallowed under section 24(b).

* * * * *

(26 U.S.C. 1952 ed., Sec. 24.)

STATEMENT

The taxpayer corporation was owned in equal shares by David Radom and his sister Anna Neidorff. During 1950 and for some time thereafter, Radom and Neidorff were engaged in a personal controversy relating to the control of the corporation. The controversy resulted in protracted litigation in the New York State courts for the purposes of obtaining an enforced dissolution of the corporation; the final holding denied dissolution. (Pet. 22, 28–29.)

During the entire year 1950 and during the entire 75 day period thereafter, the taxpayer was prevented by Neidorff's action from making any payment to Radom in payment for services performed by him for the corporation. Neidorff refused to countersign any check for the compensation due to Radom, claiming that an offset was due to the corporation. The corporation's bank required her countersignature in order to cash a check. (Pet. 29–30.)

Radom was employed during 1950 at an agreed annual compensation of $24,400. He carried out his

duties and was entitled to receive all of this compensation but received only $6,325. The corporation was financially able to make payment of the unpaid amount of $18,075. Radom was on the cash basis of accounting and did not report as income in 1950 or 1951 any part of the salary for the year 1950 due him from the taxpayer. (Pet. 28–29.)

The taxpayer corporation was on the accrual method of accounting and in 1950 accrued the entire obligation of $18,075 as an expense and deducted the full amount, as officer's salary, from gross income for 1950. (Pet. 28, 30.)

The Commissioner issued a notice of deficiency, disallowing the salary deduction of $18,075 pursuant to Section 24(c) of the Internal Revenue Code of 1939. The full assessment, together with interest, was paid. A claim for refund was disallowed and suit was brought. (Pet. 30–32.) The Court of Claims sustained the disallowance, holding that Radom had not actually or constructively[1] received payment within the statutory period, *i.e.*, not later than two and one-half months after the close of the taxpayer's taxable year, and thus the bar of Section 24(c) was not avoided by the taxpayer corporation. (Pet. 25–26.)

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[1] By election, taxpayer and Radom sought to bring themselves within the terms of an amendment to Section 24(c) (Technical Changes Act of 1953, c. 512, 67 Stat. 615) under which constructive receipt of payment within two and one-half months after the close of the payor's taxable year would satisfy the statute. However, the court below held that taxpayer had not met the burden of proving either actual or constructive payment within the statutory period. (Pet. 23, 25–26.)

ARGUMENT

The decision below is correct, there is no conflict, and further review is not warranted.

1. This case involves the application of a most explicit statutory provision prohibiting a deduction under the particular circumstances here involved. The Court of Claims accordingly held that Section 24(c) of the Internal Revenue Code of 1939 (*supra*, pp. 2–3) bars the deduction sought by the corporate taxpayer.[2]

The Internal Revenue Code of 1939, in Section 23(a)(1), authorizes as a deduction from income all of the ordinary and necessary business expenses, including a reasonable allowance for salaries. However, in Section 24(c), the Code provides that no such deduction shall be allowed for such expenses under Section 23(a) in specified circumstances. The deduction is denied an accrual basis taxpayer (1) if the expenses are not paid within the taxpayer's taxable year or within two and one-half months after the end thereof; and (2) if within this period it is not includible in the gross income of the person to whom the payment is to be made; and (3) if, by reason of the method of accounting of the payee, the amount thereof is not, unless paid, includible in the gross income of such person for the taxable year; and (4) if, at the close of the taxable year of the taxpayer or

[2] It is fundamental that to be entitled to a deduction a taxpayer must bring his case clearly within the conditions contained in the statute. *United States* v. *Olympia Radio & Television*, 349 U.S. 232, 236. *White* v. *United States*, 305 U.S. 281, 292; *Deputy* v. *duPont*, 308 U.S. 488, 493; *New Colonial Co.* v. *Helvering*, 292 U.S. 435, 440.

within two and one-half months thereafter both the taxpayer and the person to whom the payment is to be made are persons between whom losses from even *bona fide* sales or exchanges of property would be disallowed under Section 24(b).[3] If all of these circumstances, as outlined in Section 24(c), are present, an item, otherwise deductible, is to be disallowed. *Anthony P. Miller, Inc.* v. *Commissioner,* 164 F. 2d 268 (C.A. 3d), certiorari denied, 333 U.S. 861; *P. G. Lake, Inc.* v. *Commissioner,* 148 F. 2d 898 (C.A. 5th), certiorari denied, 326 U.S. 732.

The facts of the instant case clearly fall within the section. The taxpayer is on an accrual basis; the salary was accrued, but was not paid to Radom within the specified period; the salary was not includible in Radom's gross income within that period because he is a cash basis taxpayer; and Radom and the taxpayer were, within the taxable year, persons between whom losses would be disallowed under Section 24(b).

There is no merit to the taxpayer's contention that the statute should be confined to cases of tax avoidance. This case comes squarely within the statutory terms and there is nothing in the language of the

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[3] Section 24(b)(1)(B) provides that losses shall be disallowed between an individual and a corporation more than 50 per cent of the stock of which is owned by such individual. Section 24(b)(2)(B) provides that an individual shall be considered as owning the stock owned by his family. Section 24(b)(2)(D) states that brothers and sisters of the whole or half blood are included in "family". Thus for the purposes of the section, Radom is considered as owning the stock of Neidorff, thereby increasing his ownership to 100 per cent.

provision to suggest that motive is a relevant factor. There is therefore no basis for refusing to apply the provision as written. See *Helvering* v. *City Bank Co.*, 296 U.S. 85, 89; *A B C Brewing Corp.* v. *Commissioner*, 224 F. 2d 483, 487 (C.A. 9th). Moreover, as the Court of Claims observed (Pet. 26), the legislative history does not show that the statute was designed to include only situations involving tax avoidance. Other courts likewise have held, in situations in which there was no question of tax avoidance, that the prohibition was to be applied in accordance with its plain terms. *Lincoln Storage-Warehouses* v. *Commissioner*, 189 F. 2d 337, 343 (C.A. 3d); *Mansuss Realty Co.* v. *Commissioner*, 143 F. 2d 286 (C.A. 2d); *Cheltenham & Abington Sewerage Co.* v. *Commissioner*, decided March 28, 1942 (1942 P-H B.T.A. Memorandum Decisions, par. 42,182), affirmed *per curiam*, 131 F. 2d 863 (C.A. 3d). See I.T. 3319, 1939-2 Cum. Bull. 161.

2. There is no conflict with this Court's decision in *McWilliams* v. *Commissioner*, 331 U.S. 694. That case did not involve the prohibition of Section 24(c); rather, it was concerned with the application of Section 24(b), which prohibits deductions for losses from sales or exchanges of property, directly or indirectly, between members of a family and between certain other closely related individuals and corporations. In that case, the Court held that Section 24(b) stated an absolute prohibition against the allowance of losses on any sales between the members of certain designated groups and that the legislative history supported this construction.

McCarty v. *Cripe*, 201 F. 2d 679 (C.A. 7th), also involved the application of Section 24(b). That case turns on the holding that an enforced judicial tax sale broke the relationship between the former owner and the party who ultimately bought in the property, with the result that there was no sale or exchange as between persons of the designated classes. In the instant case, there is no question that taxpayer and Radom stand in the relationship described in Section 24(b).

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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